market value. The Notice merely assumes that ratepayers should reap any benefits of a close, long-term relationship that may exist between carriers and affiliates, even though such a relationship may or may not exist between affiliates and third parties.

The Commission's opposition to prevailing company price is built upon a faulty premise that fair market value is different for affiliates and non-affiliates. There is no basis for this belief. U S WEST believes that prevailing company prices are an appropriate method of valuing affiliate transactions where the prevailing company prices represent fair market value. These prices in no way disadvantage ratepayers.

Finally, the Notice proposes two methods for measuring output to determine whether an affiliate has met the threshold percentage that establishes predominant purpose.[41] U S WEST believes that, because an affiliate's predominant purpose is irrelevant to establishing whether its prevailing company prices reflect fair market value, the affiliate's output is also irrelevant. However, if the Commission insists on using such a measure, U S WEST believes the Notice's second alternative, measuring output on historical data, is the simplest and easiest method to administer and audit. The Notice's first alternative, measuring output based upon the current year's data, is unnecessarily cumbersome and difficult to administer, given the size and complexity of a carrier's operations.

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[41] Id. at 30 ¶ 82.

VII. THE DEFINITIONAL DISTINCTION BETWEEN ASSETS AND SERVICES FURTHER SUPPORTS THE RETENTION OF THE COMMISSION'S EXISTING VALUATION METHOD FOR SERVICES

In the Notice, the Commission invites comment on how it should define assets and services if it continues to distinguish between those two kinds of transactions.[42] U S WEST urges the Commission to adopt the following definitions and concepts for assets and services:

> Assets shall be defined as probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.[43]
>
> Services shall be defined as transactions between a seller and a purchaser in which, for a mutually agreed price, the seller performs, agrees to perform, agrees to perform at a later date, or agrees to maintain readiness to perform an act or acts, including permitting others to use enterprise resources that do not alone produce a tangible commodity or product as the principal intended result.[44]

U S WEST believes that the above definitions promulgated by the Financial Accounting Standards Board support maintaining the distinction between assets and services in the affiliate transaction rules. The definitions identify two characteristics that separate asset transactions from service transactions: 1) assets embody future economic benefits; and 2) services are not tangible.

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[42] Id. at 19 n.48.

[43] Financial Accounting Standards Board Statement of Concepts No. 6, Elements of Financial Statements, ¶ 25.

[44] Financial Accounting Standards Board Invitation to Comment, Accounting for Certain Service Transactions, ¶ 7.

Asset transactions embody a probable future benefit through a contribution to future net cash inflows. That is, the acquisition of an asset provides a future benefit because a company will use the asset to produce products and services that generate future revenues. Conversely, services do not provide future benefits. Service transactions are based upon performance. Companies receive value from services at the time services are performed. Consequently, services cannot be stored to provide future benefits. Thus, by definition, services can never be assets of a company.

Services, by definition, are not tangible. That is, services have no physical existence. Services are performance-based and usually labor-intensive. Performance is evidenced by the completion of a defined act or the passage of time. Services are not evidenced by the delivery of a physical product. Conversely, assets may be either tangible or intangible. Examples of tangible assets include buildings, equipment, furniture and fixtures. Examples of intangible assets include patents, trademarks and copyrights. In the case of affiliate transactions, the most common type of asset transaction is evidenced by the transfer or delivery of a physical asset from one entity to another.

From an accounting perspective, the performance-based, intangible nature of service transactions is a quite different concept from the delivery-based, tangible nature of most asset transactions. Therefore, U S WEST believes that it remains appropriate to continue the distinction between asset transfers and service transactions in the Commission's affiliate transaction rules.

VIII. THE PROPOSED TRACING OF CHAIN TRANSACTIONS, AS IT RELATES TO SERVICES, WOULD IMPOSE SIGNIFICANT BURDENS ON CARRIERS AND PROVIDE NO ADDITIONAL BENEFITS TO RATEPAYERS

In the Notice, the Commission would require carriers to "trace" resources for any affiliate transaction involving chaining.[45] Although the Notice references "products,"[46] it is uncertain whether this proposal would be equally applicable to services. If this is true, U S WEST opposes the proposal to extend a tracing requirement to services for the following reasons:

- the tracing of service-based affiliate chain transactions is unnecessary and is not feasible;
- the proposed tracing of chain transactions places potential unnecessary administrative and cost burdens upon carriers; and
- tracing of chain transactions would provide no discernible benefit to ratepayers.

The proposed rules in the Notice for tracing chain transactions are unclear as to whether this requirement would apply to asset-based transactions, service-based transactions, or both. The distinction between asset and service-based affiliate chain transactions is crucial because of the impacts on regulated cost

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[45] Notice at 20 ¶ 49.

[46] Id. at 19-20 ¶ 48.

of service, and any opportunities for cross-subsidization are uniquely different between the two.

Service-based transactions do not result in the "chaining" of tangible investment because no tangible asset is provided or produced. Instead, services are immediately consumed. Therefore, there is no asset to which costs can be added through any form of chaining process, including additional rates of return. Additionally, since service-based transactions, by definition, are evidenced by the completion of a defined act or the passage of time,[47] there is no tangible product to visually trace through successive affiliates. These concerns indicate the infeasibility, regardless of cost, of complying with this proposal to trace service-based affiliate chain transactions.

The proposed rules for tracing chain transactions would effectively result in carriers having to dissect each element of all affiliated interest costs that are recorded in the regulated books. This dissection, as interpreted from the proposed chaining rules, would necessarily have to extend to the very origin of the cost and, therefore, potentially extend through multiple affiliates. This, coupled with the generally homogeneous nature of costs to provide services, clearly calls into question the expansive nature and the very feasibility for carriers to be able to comply with this proposal. Consequently, the Commission's

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[47] See discussion infra Section VII. "The Definitional Distinction Between Assets and Services Further Supports the Retention of the Commission's Existing Valuation Method for Services".

proposal would require carriers to engage in a pointless exercise of charting the allocation of affiliate costs through all affiliate transactions.

Accordingly, U S WEST opposes the Commission's proposal in the Notice requiring carriers to "trace" chain transactions, insofar as this proposal relates to the provision of services, and requests additional clarification and explanation from the Commission to eliminate the ambiguity between the treatment of assets and services as to the proposed affiliated chaining transactions requirement.

IX. QUANTIFICATION OF COSTS

The Notice invites commenters to quantify the impact each of the methods proposed by the Commission would have on regulated operations.[48] The Commission recognizes that the costing methods it proposes for affiliate transactions would impose burdens on carriers.[49]

Although U S WEST has not been able to fully determine the additional costs to implement the Notice as proposed, increases in the following areas are certain. U S WEST currently has 73 non-tariffed services listed in its CAM. Consequently, fair market value studies would be required for each service. This determination will require additional labor hours to conduct or additional expense dollars to purchase and analyze those studies.

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[48] Id. at 38 ¶ 109.

[49] Id. at 18 ¶ 43.

Moreover, incremental labor hours will be required to implement and administer additional recordkeeping that would be required, such as the Commission's quarterly true-up proposal. There will also be incremental audit hours involved for the testing required to ensure compliance with the new rules. These incremental costs are expected to be significant and will be borne by the ratepayer.

X. QUARTERLY TRUE-UPS ARE UNNECESSARY AND ADD AN ADDITIONAL COST BURDEN ON CARRIERS FOR WHICH THERE IS NO BENEFIT

In the Notice, the Commission proposes to require carriers to monitor the accuracy of their estimated costs of affiliate transactions by comparing them with actual results on a quarterly basis. The Commission would require carriers to update their estimates for use in recording future affiliate transactions, should a deviation occur.[50]

The Notice's proposed quarterly true-ups are unnecessary and add an additional cost burden on carriers for which there is no benefit. U S WEST has relied upon prior year historical actuals, adjusted for known and material quantifiable changes, to develop its costs for affiliated transactions and other billing situations, such as damage claims. This methodology is far more accurate, easier to audit and more defensible than a methodology based upon budgets. It is far more cost effective to rely upon historical data than upon estimates because the former are known,

[50] Id. at 29-30 ¶ 79.

measurable and constant. Conversely, estimates and forecasts are fluid and change as new information becomes available. Furthermore, historical data have been used for years in the separations process, as required,[51] as a cost apportionment basis. Therefore, it is only reasonable and prudent that historical data, adjusted for known and material quantifiable changes, rather than estimates and forecasts, be used to determine the costs associated with affiliate transactions.

There is no value or benefit to ratepayers in truing up actuals quarterly. Such an effort is unnecessary and will result in incremental carrier costs which ultimately will be passed on to the ratepayers. Any true-ups should be completed annually, after the end of each year when the results for the given period become available.

XI. THE COMMISSION SHOULD NOT AMEND THE AFFILIATE TRANSACTION RULES FOR NONREGULATED OPERATIONS

In the Notice, the Commission asserts that nonregulated operations within a carrier should be subject to the affiliate transaction rules per the Joint Cost Order.[52] The Commission proposes to clarify this by requiring that cost manuals identify these nonregulated operations and provide the same information for nonregulated operations' affiliate transactions as presently

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[51]Pursuant to Part 36 and Part 69 of the Commission's Rules.

[52]Notice at 38 ¶ 108.

required for other affiliate transactions.[53] The Joint Cost Order does not subject a carrier's nonregulated operations to the affiliate transactions pricing rules. In fact, it is interesting to note that the Commission has specifically stated that "[w]hen a carrier provides a nonregulated service to its affiliate and records the transaction in a nonregulated revenue account, § 32.27 does not apply."[54] After such costs have been subject to the cost apportionment rules (Part 64.904) and have been classified to the carrier's nonregulated operations, these costs have been removed from regulation. Consequently, there is no ratepayer benefit or purpose in modifying current cost allocation manual requirements for carriers' nonregulated services offered to nonregulated affiliates.

In the Notice, the Commission also invites comments respecting post-Part 64 cost apportionments.[55] In particular, the Commission uses an example of a digital switch employed to serve both regulated and nonregulated activities which is allocated based upon the peak nonregulated usage forecast.[56] The Commission asserts that if the same switch is used to provide nonregulated services to both affiliates and non-affiliates, current rules require that this amount be further apportioned between

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[53]Id. at 33 ¶ 93.

[54]In the Matter of United Telephone System Companies' Permanent Cost Allocation Manuals for the Separation of Regulated and Nonregulated Costs, Order, 7 FCC Rcd. 4370, 4371 ¶ 12 (1992).

[55]Notice at 22 ¶ 55.

[56]Id.

affiliates and third parties.[57] The Commission then suggests that additional apportionment procedures are needed to break the affiliate amounts down by price (e.g., FDC or prevailing company price).[58]

Currently, no rules exist requiring further apportionment between affiliates and third parties after Part 64. The affiliate transaction rules, which reside in Part 32, dictate how carriers record costs in USOA accounts. Once those costs are recorded, they are allocated between regulated and nonregulated operations through Part 64, and the nonregulated portion is removed from regulated cost of service. Accordingly, further allocation is pointless.

XII. CARRIERS SHOULD BE PERMITTED TO USE EITHER THE INTERSTATE RATE OR WEIGHTED AVERAGE OF THE INTER/INTRASTATE RATES

The Notice invites comment on whether the Commission should require or permit any LEC to determine the return component of affiliate transaction costs using a composite of the prescribed interstate rate of return and the intrastate rates of return prescribed or authorized for that LEC.[59]

The cost of capital of the carrier reflects the weighted average rate of return of all jurisdictions (interstate/intrastate) in which the carrier operates. If the interstate rate of

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[57] Id.

[58] Id.

[59] Id. at 27-28 ¶ 71.

return is less than the weighted average rate of return and the rules require the carrier to include only the interstate rate of return in the amount it charges to other affiliates, the difference between the weighted average rate and the interstate rate not allowed to be charged constitutes confiscation because the carrier would not recover its full costs. The same rationale holds true from the nonregulated affiliate's perspective.

U S WEST makes its decisions regarding capital structure on a total entity basis. Interstate operations comprise approximately twenty-five percent (25%) of USWC's business, with the balance being intrastate. It is inappropriate for the interstate rate of return to be controlling in these circumstances. Therefore, carriers and their affiliates should be permitted to use (and disclose in their CAMs) either the interstate rate or the weighted average of the inter/intrastate rates of return.

XIII. CONCLUSION

For the foregoing reasons, U S WEST strongly opposes the Commission's proposed rules. The Commission's proposed rules are based upon unsubstantiated presumptions regarding cross-subsidization and carrier imprudence and would unnecessarily burden carriers. Moreover, the Commission's action would undermine its past efforts to strike a balance between encouraging innovation, efficiency and productivity and maintaining the necessary safeguards to prevent cross-subsidization and discrimination. The present safeguards, when coupled with efficiency and productivity initiatives, are sufficient to allay the Commission's concerns with regard to cross-subsidization and the protection of rate-payers. Finally, it would be premature for the Commission to adopt its proposed rules in this proceeding prior to the resolution of its LEC price cap performance reviews in 1994.

Accordingly, the Commission's proposed rules should not be adopted.

Respectfully submitted,

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December 10, 1993

EXHIBIT A

USWC VALUE STUDY HISTORY

AFFILIATE	FIRM/DATE	SCOPE	REMARKS
U S WEST COMMUNICATION SVCS – provides marketing svcs for lge bus, gov & educ, small bus and home & personal svcs	Coopers & Lybrand Jan– Mar, 1991	100% of cost	Study evaluated two types of providers of marketing services. Independent agents providing similar services to USWC and alternative providers. The alternative provider analysis confirmed that there are organizations that provide telecomm svcs marketing. C&L could not determine if they could provide the full range of svcs. C&L did determine that the Bell operating companies & other independents do provide these services within their regions. "Therefore, these firms represent alternate performers, but may not represent alternate providers." The other group, independent agents were found to be dissimilar because 1)they do not provide product and market management functions 2) USWC's focus is strategic and major customer while the independent agents focus on general customers 3) USWCS's focus is on managing existing customer & associated network revenues. This is not an independent agent focus.
U S WEST SERVICE LINK – provides specialized operator svcs	KPMG Peat Marwick Feb–Dec, 1990	100% of cost	A market for operator svc does exist, but market price information for that market is extremely difficult to obtain. From the supplier perspective the study demontrated that is it difficult to collect competitive price information due to factors including – the competitive nature of the industry, the time and effort required to complete the case study portion of the survey, and the lack of incentive (i.e. a formal RFP) to provide price estimates.
U S WEST, INC. – provides headquarters type svcs like as well as strategic mktg	Deloite & Touche Aug–Dec, 1989	75% of cost	From the analysis of D&T it was concluded that 70 of the 85 services could be performed by an outside service provider. However, it was noted that there would be an increase of about 38% in cost which reflected the fact that certain activities, such as elements of corporate finance and accounting, and treasury did not lend themselves to external performance due due to a need to maintain close oversight or control. The study found it was more cost effective for USWC to continue receiving the benefits of USWI activity performance than to have an external provider.
U S WEST BUSINESS RESOURCES – provides procurement and adm svcs, incl flight, fleet and real estate	Coopers & Lybrand 1988	43% of cost	Study determined that there were services similar in scope and performance standards available from external companies. It was also determined that certain services offered by BRI could not be provided by external providers because as with centralized services there would be a of loss of efficiences or as with company furnished items like buildings and computer there were systems that were linked. The study drew no conclusion as to the viability of achieving cost reductions through contracting. Factors other than pricing should also be considered in the contracting decision.
U S WEST BUSINESS RESOURCES	Coopers & Lybrand Mar–Oct, 1990	update of 1988 study	In March, 1990 C&L was retained to update the study. It was recognized that the major mgmt svc companies who participated in the 1988 study would be unwilling to provide the same level of effort and detail as they provided in the 1988 study. In addition, the scope of the study includes the entire USWC territory rather than just the PNB svc territory. Therefore, C&L had to develop methodology which relied on updating the 1988 prices using published inflation data and regional wage indices.
U S WEST ADVANCED TECHNOLOGIES – provides research & development svcs	Terry Saracino Jun–Dec, 1988		The focus of the study was to document the type of work performed by USWAT and its benefit to USWC. The study did not include a quantification of the cost for USWC to perform similar services internally nor did it assess external market comparability. The type of work performed at USWAT is highly technical and requires expertise not generally found within the telecommunications operating company environment.

BELLCORE/U S WEST ADVANCED TECH – provides research & development svcs	Coopers & Lybrand Sep,1990–Jun, 1991	100% of cost	C&L's analysis of the marketplace findings were as follows – 1) no single organization provides the scope and magnitude of services, 2) 26 organizations perform comparable work, 3) the large majority of the organizations perform work only for internal use, 4) alternate performers are not likely to be experienced in pricing the services for outside users, 5) obtaining market price comparisons for BCR and USWAT services is not feasible, 6) internal cost information is highly confidential and not available from public sources, and 7) benchmarking, comparing cost structures and internal efficiencies, is a viable alternative to market pricing comparisons.

CERTIFICATE OF SERVICE

I, Kelseau Powe, Jr., do hereby certify that on this 10th day of December, 1993, I have caused a copy of the foregoing **U S WEST COMMENTS** to be served via first-class United States Mail, postage prepaid, upon the persons listed on the attached service list.

Kelseau Powe, Jr.

Kelseau Powe, Jr.

***Via Hand-Delivery**

(CC93-251/DM/lh)

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